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SIPDIS

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TREASURY FOR OAISA/RALYEA/CUSHMAN  
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E.O. 12958: N/A

TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF

SUBJECT: South African Economic Growth Still Expanding

**11.** Summary. The September 2005 Quarterly Bulletin describes an expanding South African domestic economy, operating at close to its long-term potential. In the second quarter 2005, real GDP growth reached 4.8%, up from the first quarter's growth of 3.5%. Domestic demand's growth in the second quarter more than doubled the first quarter's growth, primarily due to a recovery in government consumption expenditures. Consumer spending remains strong. Household disposable income showed 5.7% growth in the second quarter. Rising asset prices, high consumer confidence, low inflation and interest rates also support strong consumer spending. Increased credit financed consumer spending, with the household debt to disposable income ratio reaching 61.8% in the second quarter, compared to 51.4% six quarters earlier. If interest rates increase in the future, the high debt may serve as a brake for continued robust consumer spending.  
End Summary.

The Domestic Economy Powers On

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**12.** Real domestic demand (excluding the foreign sector), now in its 18th quarter of positive growth, expanded 4.9% in the second quarter 2005 compared to 1.7% in the previous quarter. A higher growth in government consumption expenditures and inventories explained the second quarter recovery in domestic demand growth. Fixed capital formation by general government increased as the government boosted spending on infrastructure. Real spending on capital formation increased 5.7% and inventories more than doubled in the second quarter 2005. The highest real sectoral growth rates came from the agricultural industry, at 10.1%; manufacturing, at 7.3%; transport and communication, at 6.4% and construction posting 6.2% growth.

Consumption and Investment Still Growing

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**13.** Total consumption accounts for over 80% of domestic demand, with households two thirds of consumption spending. Household spending strengthened slightly in the 2nd quarter, growing by 5.9%, although government consumption accounted for most of total consumption's rebound in 2nd quarter growth, reaching 5.7%. Government consumption expenditures increased by 5.3%, compared to 1.2% last quarter, due to higher real compensation of employees and increased spending on intermediate goods and services.

**14.** A substantial part of this increased spending was financed by credit, pushing the household debt to income ratio up to 61.8% in the second quarter 2005 compared to 2003 fourth quarter's ratio at 51.4%. Increased equity prices, low interest rates and inflation (so far), and rising disposable incomes have fueled debt acquisition. Household disposable income increased 5.7 percent in the 2nd quarter 2005. If inflation increases more than anticipated and interest rates rise, households may reduce their debt exposure, providing a possible brake to robust consumer spending.

**15.** Real capital formation increased 5.7% in the second quarter, although down from 1st quarter's growth of 10.1% due to reductions in capital outlays of public corporations. (Note SAA purchased three aircraft in the first quarter 2005. Endnote) Private sector investment increased 4.0%, similar to 1st quarter's growth, with investment in commerce, transport and real estate leading the way.

Current Account Deficit Narrows

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**16.** Both exports and imports staged second quarter recovery, with both increasing over 20% compared to last quarter's declines of 13% and 17%, respectively. When measured as a percentage of GDP, the current account improved from 3.8% in the first quarter to 3.4% in the

second quarter 2005.

17. Total exports from the Euro-zone declined during the second quarter; exports to Asian nations increased by 28.6% (compared to 24.5% in the first quarter 2005) and exports to North and South America remained unchanged. During 2nd quarter 2005, merchandise imports increased by 6.5% after declining by 4.5% in the first quarter, primarily because of an increase in oil imports.

18. Comment. Indicators point to over 4% GDP growth in 2005, although GDP will fall short of 6% growth needed to meet government's goal of halving unemployment and poverty by 2014. Government's strategies to achieve higher levels of economic growth are focused on raising the levels of investment, improving the skills of the workforce, introducing new technologies, and improving the infrastructure of the transportation, utilities and telecommunication sectors. A recent IMF report on South Africa emphasized necessary reforms such as highlighted labor market flexibility, increased privatization, and trade liberalization to achieve 5.5 percent growth and 18% unemployment by 2010. The South African government is exploring ways of achieving 6% growth with task force (made up of the Ministers of the Department of Trade and Industry, Finance, Public Enterprises and the Deputy President) recommendations due later this year. Higher than expected inflation and subsequent increased interest rates pose possible obstacles to 4% growth in 2005, although most analysts expect interest rates to remain stable over the year. End comment.

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